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SUBJECT: NORWEGIAN ECONOMY: STILL FLOATING, BUT ICEBERGS
AHEAD?

REF: OSLO 567

1. (SBU) Summary. Norway's energetic economy receives waves of ill financial news. With slowing economic growth, decreasing energy prices hit the major oil and gas-producing nation particularly hard. The Pension Fund (Global), one of the world's largest sovereign wealth funds, has posted significant third quarter losses. Nevertheless, Norway's economy still continues to grow, and is considered largely insulated from the brunt of global financial shocks. The GON has also stepped in with several rescue packages, trying to shore up key declining sectors. Norway also continues to support aid to cash-strapped Iceland. End Summary.

The first wave a ripple...

2. (SBU) With slowed growth, and increased inflation, the Norwegian economy faces economic challenges. The country is, however, in a fairly sheltered position, with a modestly-sized banking sector, tightly regulated. The GON's current account enjoys a large surplus, and the country's finances are considered strong.

...but tides surge ahead....

3. (SBU) The Norwegian economy does face near and long-term pressures. A central challenge is frozen credit markets, characterized by high inter-bank lending rates. The Norwegian Central Bank has, in fact, become the only market for new capital. In the third quarter, Norwegian banks lost approximately 140 million USD in loans and guarantees. Banks have not covered such large credit losses since 2003. The Central Bank, in response, continues to cut its key policy rate, currently at 4.75 percent.

4. (SBU) Markets have experienced some turbulence. The Oslo Stock Exchange declined over 50 percent since its peak in May. Norwegian consumers are also feeling direct effects of a sluggish economy. Residential mortgage loans tend to be variable, and average home loans, set as high as 12 percent, have been slow to decline.

5. (SBU) Recognizing financial instability ahead, the Norwegian Labor Organization has pledged to ease demands on wage increases, focusing on saving jobs. Norwegian wages experienced an average real growth of 3.7 percent over the last 5 years. Real growth in 2009 is expected to decline sharply, to as low as 1.5 percent. Layoffs are expected to be limited, balanced by reductions of possible overtime opportunities. Certain sectors have been hit harder than others: in shipping, a 70 percent drop in new orders occurred.

6. (SBU) Other negative trends include a slowing housing market, with inventory prices declining. Overall, the construction industry has experienced a decline in new residential and commercial orders. That sector, however, has benefited from the use of temporary foreign workers.

7. (SBU) Declining global energy prices have also weakened the country's terms of trade. Moreover, overall economic growth projections for 2009 are zero, with recovery predicted in 2010-2011.

GON Rescue Packages

8. (SBU) The GON has extended an approximately 50 billion USD rescue package for its banks, while also providing shipbuilding and export industries a 7 billion USD assistance

package. Additionally, Iceland will continue to receive support from all the Nordic countries, recently pledging collectively about 2.5 billion USD.

The Fund Flounders

19. (SBU) The Global Fund has posted record losses in the third quarter--near 5 billion USD. The Fun is invested wholly in international equities. The Fund's assets are

worth approximately 300 billion USD, with the GON's aspiration equity/debt investment split quickly reaching its goal of 60 and 40 percent, respectively.

10. (SBU) Analysts note three factors when evaluating the Fund's performance: overall high global oil and gas prices in 2008, the weakening Norwegian kroner, and record revenues from Norway's hydrocarbon industry (Note: Norway's heavy energy industry tax burdens (as high as 78%), provide direct revenue to the Fund). Further, the Fund's 7.7 percent negative return in the third quarter is 1.84 percent the reference portfolio, meaning the relative returns of other markets. The confluence of all these factors has spurned criticism that the management wing of the Fund, Norges Bank Investment Management, is ineffectively managing assets.

11. (SBU) Comment. Norway's economy is still ship-shape, but Norwegian politicians are taking the opportunity to criticize its government. In particular, a Christian Democrat leader publicly criticized Prime Minister Stoltenberg as acting like the captain on the Titanic, saying everything was running smoothly while merely looking out of a porthole would reveal a different situation. Norway is still an economic powerhouse, but the global economic uncertainties may dampen the nation's energetic economy.

WHITNEY